No. 90-976

In The

Supreme Court of the United States

October Term, 1990

ANCLOTE MANOR HOSPITAL, INC.; WALTER H. WELLBORN, JR., M.D.; ARTHUR R. LAUTZ; MANUEL VALLES, JR.; ROBERT L. CROMWELL; THOMAS C. FARRINGTON, JR.; THOMAS E. McLEAN; JAMES C. TREZEVANT, JR.; SERGE BONANNI; LORRAINE HIBBS; ALBERT C. JASLOW, M.D.; ROBERT J. VAN DE WETERING, M.D.; WALTER L. COOPER; JAMES D. O'DONNELL,

Petitioners,

v.

LAWRENCE J. LEWIS, M.D.,

Respondent.

On Petition For Writ Of Certiorari To United States Court Of Appeals For The Eleventh Circuit

SUPPLEMENTAL APPENDIX TO PETITION FOR WRIT OF CERTIORARI

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UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION

LAWRENCE J. LEWIS, M.D., a contributor to Anclote Psychiatric Center, Inc., a Florida Not For Profit Corporation,

Plaintiff,

Case No: 86-654-CIV-T-13C

vs.

ANCLOTE MANOR HOSPITAL, INC., a Florida For Profit Corporation, et al.,

Defendants.

REPORT AND RECOMMENDATION

THIS CAUSE comes on for consideration[1] by the undersigned magistrate of Defendants' (Except Smith) Motion for Sanctions (Dkt. 122) following referral of by the district court for fresh consideration of the issues to determine whether sanctions and/or costs are appropriate and, if so, in what amount. An evidentiary hearing on defendants' motion was held before the undersigned on April 27 and 30, 1990.

Defendants, except Smith,[2] move for sanctions, including attorney fees, costs, and a fine against the

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[1] This matter has been referred to the undersigned by the district court for consideration and a Report and Recommendation. See Local Rules 6.01(b) and 6.01(c)(18), M.D. Fla.

[2] Except as otherwise noted, the term "defendants" when used in this Report and Recommendation shall refer to all

(Continued on following page)

plaintiff, Lawrence J. Lewis, M.D. and his attorney, on the grounds that Dr. Lewis and his attorney violated Rule 11, Fed.R.Civ.P. In addition, defendants seek extraordinary costs and fees from plaintiff's counsel under 28 U.S.C. § 1927 for multiplying the proceedings in the case as to increase costs unreasonably and vexatiously.

For the reasons stated hereafter, I find that plaintiff's counsel has violated Rule 11 by not conducting a reasonable pre-filing inquiry into certain material allegations of the complaint. I recommend that sanctions in the amount of $4,420.00 be assessed against counsel personally for the Rule 11 violation.

I. Introduction

The six-count complaint, based on federal question jurisdiction, contained claims against the defendants for common law fraud and breach of fiduciary duty (Counts One, Two and Three) and civil RICO claims (Counts Four and Five). In essence, the complaint charged that the directors of Anclote Psychiatric Center (APC), the directors' agent (Attorney O'Donnell) and Anclote Manor Hospital (AMH) sold APC's assets (a psychiatric hospital and other real property) at considerably less than fair market value to for-profit corporation AMH (controlled by the defendant directors) and then re-sold the assets for a huge profit less than 18 months later to American Medical International (AMI).

(Continued from previous page)

defendants named in the complaint except for Florida Attorney General Jim Smith.

Count Six of the complaint sought a writ of mandamus against Florida Attorney General Jim Smith due to the failure of the Florida Department of Legal Affairs after due notice to institute action against APC's directors for operating the public charity contrary to the terms of its charter, in violation of Florida Statutes, section 617.09.

The relief sought included treble damages, costs, attorney's fees, an accounting of the profits realized by defendants and injunctive relief.

The complaint stated that plaintiff, Lawrence J. Lewis, M.D. a contributor to APC, "is bringing this action on behalf of APC and has standing to do so." (Complaint at paragraph 9). It alleged that in addition to being a contributor, Dr. Lewis was APC's Medical Director and Director of Admissions.

II. Procedural Posture

The complaint was filed on May 30, 1986. On September 17, 1986, the district court denied defendants' motion to dismiss and for judgment on the pleadings which challenged *inter alia* plaintiff's lack of standing to bring the RICO action and the lack of a genuine issue of material fact as to the fraud allegations. After the parties had conducted discovery, the court, on July 7, 1987, granted summary judgment in favor of defendants, finding that plaintiff lacked standing to sue and without reaching the merits of the substantive claims.

On February 2, 1988, defendants filed the instant motion for sanctions which, by order of the district court

dated April 7, 1989, was denied.[3] In separate appeals, defendants appealed the denial of their motion for costs and plaintiff appealed the order granting summary judgment for defendants.

On January 5, 1988, the Eleventh Circuit Court of Appeals affirmed, *per curiam*, the order granting summary judgment in favor of defendants. The appellate court, in another *per curiam* opinion issued February 8, 1990 on defendants' appeal of the denial of sanctions, partially remanded the case for clarifications of the reasons for the district court's denial of defendants' motion for sanctions.

III. Issues Presented for Review

On April 24, 1990, the undersigned entered an order scheduling an evidentiary hearing to address the following issues:[4]

> 1. Whether plaintiff and his attorney made sufficient pre-filing inquiry into the facts so as to determine if the complaint was well-grounded in fact under Rule 11, Fed.R.Civ.P.;
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> 2. Whether plaintiff's attorney made sufficient pre-filing inquiry into the law regarding standing to sue to determine whether the complaint as filed was warranted by existing law or a good faith argument for the extension, modification,

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[3] In his order the Honorable William J. Castagna, district judge, also set aside an award of costs taxed by the clerk against plaintiff in the amount of $5,816.40.

[4] Counsel for plaintiff and defendants received actual notice of the hearing and obtained a copy of the order on the same date.

or reversal of existing law under Rule 11, Fed.R.Civ.P.;

3. Whether the complaint was interposed for an improper purpose under Rule 11, Fed.R.Civ.P.;

4. Whether plaintiff's attorney, by filing the complaint and proceeding with the prosecution of the case against defendant unreasonably and vexatiously multiplied the proceedings in the case under 28 U.S.C. § 1927 and the court's inherent power;

5. If sanctions are properly assessed against either plaintiff or his attorney, or both, what amount of fees and/or costs and/or expenses are defendants entitled to under either Rule 11, Fed.R.Civ.P. or 28 U.S.C. § 1927.

IV. Rule 11, Fed.R.Civ.P.

Under Rule 11, Fed.R.Civ.P., the signature of an attorney or party signing a pleading constitutes a certificate that:

> he has read the pleading, motion, or other paper; that to the best of the signer's knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. . . .

Rule 11, as amended, is judged by an objective standard of reasonableness under the circumstances viewed at the time at which the pleading was filed. *Threaf Properties Ltd. v. Title Ins. Co. of Minn.*, 875 F.2d 831, 835 (11th

Cir. 1989). Circumstances to be taken into account include:

> how much time for investigation was available to the signer; whether he had to rely on a client for information as to the facts underlying the pleading, motion or other paper; whether the pleading, motion, or other paper was based on a plausible view of the law; or whether he depended on forwarding counsel or another member of the bar.

Ibid., quoting from Advisory Committee Note to Rule 11.

A. Did Plaintiff and Counsel Conduct Adequate Pre-Filing Inquiry into the Facts?

Rule 11 on its face requires counsel to make a reasonable inquiry to determine that the pleading, motion or other paper is well-grounded in fact. Defendants contend that plaintiff and his counsel did not conduct an adequate pre-filing inquiry into the factual allegations of standing, damages and the RICO claim in the complaint. The allegations which defendants focus on in particular are the following paragraphs:

> 8. Plaintiff, Lewis, has contributed both money and property to Public Charity, and has relied therefore on its exemption from taxation under Section 501(c)(3) of the Internal Revenue Code.
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> 9. As a contributor, Medical Director, and Director of Admissions, Plaintiff, Lewis, is bringing this derivative action on behalf of Public Charity, and has standing to do so.
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> . . .
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> 16. Prior to May 1, 1983, [APC's] directors and O'Donnell as persons within the meaning of 18

> U.S.C. § 1961(3) met, and agreed to receive income derived, directly or indirectly, from a pattern of racketeering activity which was used to acquire an interest in [APC] by arranging for the sale of the assets of [APC], a corporation in which they were the sole members of the board of directors, to [AMH], a corporation in which they were the sole stockholders and directors.
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> . . .
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> 48. [APC's] directors, by using their fiduciary position as directors to obtain secret profits, [AMH] and O'Donnell have devised a scheme to defraud [APC], and said scheme was planned and agreed to by O'Donnell, and for the purpose of executing such scheme have placed in a depository for mail matter a thing to be sent by the Postal Service.
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> . . .
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> 56. Plaintiff was injured in its business and property by reason of these violations of 18 U.S.C. 1962, in that, as a direct and proximate result of the acts of Charity's Directors, For Profit Corporation, and O'Donnell, Public Charity suffered damages due to the loss of corporate opportunity in the sale of its assets to American Medical International. As such, Plaintiff is entitled to an accounting from Charity's Directors, For Profit Corporation and O'Donnell as to the distribution of the funds against the proceeds and property of the corporation, and to an award of damages for injuries sustained by Plaintiff as a result and consequence of Charity's Directors' breach of fiduciary duty.

1. What Dr. Lewis Knew

At the sanctions hearing, Dr. Lewis testified that he based his claims primarily upon his firsthand

observations and indirectly through conversations concerning the sale of APC to AMH and then AMI. (Tr. pp. 117, 147).[5]

Dr. Lewis testified that he first heard about the sale of APC to AMH for about $4.5 million from a conversation he had with Dr. Wellborn, the hospital's director, on May 10, 1983, one day after the sale. (Tr. pp. 121, 128, 159). He testified that he was concerned at the time of the sale's effects on his pension plan. (Tr. pp. 161-162).

Dr. Lewis testified that in his capacity as director of admissions he had been receiving monthly financial information concerning the hospital's operating margin and cash flow. (Tr. p. 156). This information indicated to him that the hospital was doing quite well and was, in fact, increasing its operating margin by $90,000 per month during the period October 1982 through March 1983. (Tr. pp. 157-158). At about that same time, Dr. Lewis learned that each of the directors had borrowed $40,000 for a down-payment and had taken a note secured by hospital property for the balance of the $4.5 million purchase price. (Tr. p. 160).[6] Dr. Lewis states that Dr. Wellborn told him not to tell anyone about the terms of the sale until the transaction was completed. (Tr. p. 161).

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[5] Excepts from the transcript of the hearing before the undersigned on sanctions held April 27, 1990 and April 30, 1990 shall be referred to as ("Tr. p. ___") (Volume I) and (Tr. 2 p. ___") (Volume II). The hearing exhibits shall be referred to as ("Pltf's Ex. ___") or ("Def's Ex. ___").

[6] The actual final price paid for APC's assets after taking into account the assumption of APC's liabilities, according to the testimony of Mr. O'Donnell, was 6.6 million. (Tr. p. 189).

Following the conversation with Dr. Wellborn, plaintiff become concerned about the hospital changing its status to a for-profit operation. (Tr. p. 162). Dr. Lewis then decided to speak with an attorney, Mr. Freeborn, at a Rotary Club meeting concerning the facts of the sale. (Tr. p. 162). Mr. Freeborn told plaintiff that the sale had to be arms-length and the price would have to be the fair market value and that he would have to see some documentation. (Tr. p. 162).

Plaintiff continued working at the hospital and sometime in September, 1983 decided to call a former justice of the Florida Supreme Court, attorney Arthur England. (Tr. pp. 129, 163-164). According to Dr. Lewis, Mr. England stated that he would look into the sale but that he needed to see a copy of the APC charter and IRS-related documents. (Tr. p. 164). Dr. Lewis related to England that he believed the sale of APC to the directors was in violation of the not-for-profit hospital's charter in that the hospital was being changed into a for-profit corporation and that the earnings of the hospital would go to the benefit of private individuals, the directors, rather than for charitable purposes. (Tr. p. 164). Mr. England told plaintiff that the case would be expensive to litigate and that it would be necessary to get expert witnesses. (Tr. p. 164). He also told plaintiff that the Florida Attorney General's office did not have the staff or the resources to follow through on a complaint unless they had documentation and advancement of funds. (Tr. p. 164).

Mr. England also told plaintiff that he would have to call Mr. Rosenkrantz, the attorney for APC who helped negotiate the sale on behalf of the seller, in order to find

out more about the sale. (Tr. pp. 148, 164). Plaintiff testified that he told Mr. England not to inquire into the facts of the sale with Mr. Rosenkrantz because he was afraid he would "lose his job" with the hospital. (Tr. pp. 148, 164).

It appears that plaintiff did not inquire of Dr. Wellborn into the bases for his suspicions concerning the sale nor did he inquire into the specifics of the sale's terms or APC's worth although Dr. Wellborn did tell plaintiff that there had been an appraisal. (Tr. pp. 141, 161-162).

Dr. Lewis also testified that he had several conversations with hospital personnel prior to filing suit which led him to believe that APC was sold for an inadequate price to the corporation controlled by the directors. (Tr. pp. 168-181). Dr. Randy Smith told plaintiff while the former was interviewing for a job that, one of the directors, Dr. Van de Wetering, said that the directors had bought the hospital in order to resell it for a profit. (Tr. p. 172).

Plaintiff testified that after putting together all of the financial information, the sales price information, his knowledge of the assets of APC, the statements of others concerning the value of APC and the motivations, of the directors, as well as a review of APC's charter,[7] he came to the conclusion that the directors sold APC's assets to themselves for less than fair market value in violation of

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[7] APC's Articles of Incorporation provide that the corporation is to be operated exclusively for scientific, educational and charitable purposes and that no part of its net earnings shall inure to the benefit of any private shareholder or individual. The board of directors constitute the membership of the corporation. (Pltf's Ex. 1).

the charter and resold them at a much higher price. (Tr. pp. 138-139; 174-175; 179). He stated that the directors were knowledgeable about the financial aspects of the hospital and had to know that the property was undervalued at the time of the May 1983 sale and that, therefore, they had committed fraud against APC and breached their fiduciary duties. (Tr. p. 179).

As for Mr. O'Donnell's role in the alleged fraudulent scheme, Dr. Lewis knew only that Mr. O'Donnell had represented APC in the 1983 sale and then represented AMH after the sale. He knew that Mr. O'Donnell had obtained some type of "hypothetical" private ruling letter from the IRS concerning the sale. However, he thought that Mr. O'Donnell had "represented both sides at one time or another". Although he learned that Mr. Rosenkrantz, another attorney, was brought in to represent APC in the negotiations, Dr. Lewis was not totally clear about the role which Mr. Rosenkrantz played in the transaction. (Tr. pp. 140-141; 146-147; 149-150).

Plaintiff admits that he never contacted Mr. Rosenkrantz and apparently never contacted Mr. O'Donnell. (Tr. pp. 140-141; 147, 153-154). However, given his position as an employee and his belief that the directors themselves were the wrongdoers, the undersigned concludes that it was not unreasonable for Dr. Lewis to refrain from further research prior to contacting counsel who then had the responsibility to research the law and conduct further research into the facts, if necessary, to determine if relief was appropriate. Defendants have made much of the fact that plaintiff waited until May 30, 1986 to bring suit. However, and sale to AMI did not take place until the fall of 1985, and it was not until then that

it was apparent that the hospital would be resold for substantially more than its 1983 purchase price, i.e. about $29.5 million. (Tr. p. 135-136).

2. Counsel's Inquiry into the Facts

Plaintiff's counsel was retained by plaintiff in February 1986. Prior to filing suit on May 30, 1986, and signing the complaint, plaintiff's counsel conducted only very limited factual inquiry into the circumstances outlined in the complaint.

Prior to filing suit, plaintiff's counsel did determine that Dr. Lewis had in fact made charitable contributions to APC in 1979. (Tr. p. 18). He knew that the IRS had not disallowed Lewis' deductions based on those contributions within the three-year statute of limitations set forth in 26 U.S.C. §6501(a) but as a tax attorney, counsel was aware, however, that there were exceptions to the three-year period. (Tr. p. 19).

At the hearing on sanctions, plaintiff's counsel testified that other than what his client told him,[8] his only pre-filing factual inquiry was a public records search of real estate filings concerning the two sales transactions in 1983 and 1985, counsel verified the tremendous difference

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[8] Plaintiff's counsel invoked the attorney-client privilege on numerous occasions during the sanctions hearing as to anything that he learned from his client. (*See e.g.* Tr. pp. 8-9, 22, 26, 30, 34, 43, 47, 62, 148). The applicability of the privilege in a Rule 11 hearing is a difficult issue. Although there was no testimony presented at the hearing that Dr. Lewis told counsel all that he knew, the undersigned will assume that to be the case.

in price by examining the documentary stamps. (Tr. pp. 23, 26). Plaintiff's counsel admits that he never requested to see the closing package of sale documents prior to filing suit, nor did he interview any of the individuals who furnished Dr. Lewis with information. (Tr. pp. 28, 32).

With regard to plaintiff's RICO claim, plaintiff's counsel simply assumed that the interstate wires and mails were used to effectuate a fraud because he learned from his client that one of the directors lived in Atlanta, Georgia. (Tr. pp. 63, 117). All of the documents pertaining to use of the mails and long distance telephone calls were obtained by plaintiff's counsel through discovery after the case was filed. (Tr. pp. 46-49, 63).

In particular, plaintiff's counsel did not take any steps whatsoever to determine the factual basis for certain RICO allegations. Yet the complaint alleges that Mr. O'Donnell along with the other defendants "agreed to receive income . . . from a pattern of racketeering activity . . . which was used to acquire an interest in [APC] by arranging for the sale of the assets of [APC] to [AMH]. (Complaint paragraph 16) and "devised a scheme to defraud [APC] . . . planned and agreed to by O'Donnell . . . and for the purpose of executing such scheme [used the mails]" (Complaint, paragraph 48). Counsel made no pre-filing inquiry to support these statements and others other than the public records search and what he learned from Dr. Lewis. (Tr. pp. 21-23; 26; 28; 33-34; 41-43; 62-63).

Similar allegations about Mr. O'Donnell's actions and those of the other defendants are contained in other paragraphs of the complaint: 49-51 (use of the wires and

mails in a scheme to defraud) and 52-55 (commission of acts constituting a pattern of racketeering activities).

Instead of carefully investigating his client's allegations, plaintiff's counsel merely assumed from the gross disparity in prices in the 1983 and 1985 sales and the terms of the APC charter that defendants had committed fraud and violated the RICO Act.

Some courts, after examining the particular circumstances involved, have found an inadequate pre-filing inquiry into the facts where counsel failed to contact pertinent witnesses or review all relevant documents in the client's possession or which otherwise are reasonably obtainable before filing suit. *See generally In re Ginther*, 791 F.2d 1151, 1155 (5th Cir. 1986); *Albright v. Upjohn Co.*, 788 F.2d 1217, 1221 (6th Cir. 1986). A reasonable inquiry into fact ordinarily requires more than exclusive reliance on representations of fact made by the client. *See Southern Leasing Partners, Ltd. v. McMullan*, 801 F.2d 783, 788 (5th Cir. 1986).

One district court has articulated the standards for a factual inquiry as follows:

> . . . . A defendant must not be joined, or claim asserted against a defendant merely in the hope that discovery will turn up something against that defendant. The cost of determining whether a defendant should be named in the action must be borne by the plaintiff and his attorney before the suit is filed. The burden cannot be shifted to a defendant to prove himself out of the case after filing.
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> . . .

> Before a defendant is named or a claim (such as a RICO claim) asserted against a defendant, the attorney's file should contain facts admissible in evidence, or at least facts indicating the probable existence of evidence, implicating that defendant or supporting that claim.
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> . . .
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> . . . [A]n attorney would be well advised to make as thorough an investigation as possible, perhaps even writing to the prospective defendants requesting access to their files, or asking for their side of the story. If the door is slammed in his face, he will have documented that he made what investigation he could.

(Footnotes omitted). *Whittington v. Ohio River Co.*, 115 F.R.D. 201, 206-207 (E.D. Ky. 1987).

In determining whether a reasonable inquiry into fact requires more than exclusive reliance on factual representations by the client, the court should consider such factors as: (1) the availability of alternative sources of information; (2) the character of the client's knowledge, including whether it is firsthand, derivative or hearsay in nature; (3) the plausibility of the client's account; (4) the history and duration of the relationship between the attorney and the client; (5) the extent to which the attorney questioned the client. *See* American Bar Association Section of Litigation, *Standards and Guidelines for Practice Under Rule 11 of the Federal Rules of Civil Procedure*, 121 F.R.D. 101, 115 (June, 1988) ("ABA Standards for Rule 11") (citations omitted).

Although plaintiff's counsel testified at the hearing that he filed the action on May 30, 1986 because he was concerned about a possible statute of limitations problem,

he had at least three months from when he was retained to discover such information or interview witnesses so as to test his client's information and theories. (Tr. p. 106). In the case at bar, when much of the client's information leading to his conclusions of wrongdoing were based on hearsay statements and "putting two and two together," counsel had an even greater duty to conduct further investigation before filing suit. There is no indication that plaintiff's counsel had previously represented Dr. Lewis. Plaintiff's counsel gave no testimony regarding how extensively he questioned his client as to the information furnished by him.

To determine the adequacy of pre-filing inquiry, this circuit has stated that it must "focus on what was reasonable for an attorney to believe at the time the pleadings were filed, not what the court later found to be the case." *Threaf Properties v. Title Ins. Co. of Minnesota*, 875 F.2d at 835.

In *Threaf*, the Eleventh Circuit reversed the district court's award of Rule 11 sanctions because it found that counsel had conducted an adequate pre-filing inquiry into the facts in a breach of contract case to certify that the complaint was well grounded in fact. In that case, the court cite the steps taken by plaintiff's first counsel which included the following: examination of the entire file, including deposition transcripts, from a prior quiet title action and a deposition in a prior criminal prosecution. Substitute counsel in the case filed a second amended complaint after reviewing the pleadings up to that point, speaking with prior counsel, reviewing documents from the criminal prosecution, and contacting another attorney

who had represented the plaintiff in the underlying real estate transaction. *Id.* at 835-837.

In contrast to the inquiry performed by counsel in *Threaf*, plaintiff's counsel in the case at bar did not review any documents other than public records which reflected the disparity of the purchase price, he did not interview witnesses or the attorneys involved in the 1983 or 1985 sales. There is no indication that he spoke with Mr. England, whom his client had initially consulted. In short, plaintiff's counsel in this case relied almost exclusively on the factual representations of his client in a case which he conceded was factually complex. (Tr. p. 56). More investigation was required under the circumstances.

The only allegations of damages in the complaint was that APC suffered a "loss of corporate opportunity" in the sale of its assets to AMI (Complaint, paragraph 56). Counsel could certify his good faith belief that there was an adequate factual basis for the damages claim because of evidence derived from counsel's public records inspection and information furnished by his client. The complaint did not allege that Dr. Lewis himself had incurred damages.

Based on information available when the complaint was filed, counsel could also properly certify his good faith belief that the allegations concerning the status of Dr. Lewis as Medical Director and Director of Admissions were also well-grounded in fact as was the allegation that plaintiff had contributed money and property to APC.

However, the preponderance of evidence indicates that plaintiff's counsel did not conduct sufficient prefiling inquiry into the facts to certify his good faith belief

that the RICO claim, the only basis for federal jurisdiction, was well grounded in fact particularly as to the allegations in the paragraphs previously discussed. Given the importance of these allegations to plaintiff's RICO claim, the only basis of federal jurisdiction, and counsel's failure to conduct a reasonable pre-filing investigation, a violation of Rule 11 has been established. *Compare Forrest Creek Associates, Ltd. v. McLean Sav. & Loan Ass'n*, 831 F. 2d 1238, 1244-1245 (4th Cir. 1987) (Rule 11 not violated where counsel conducted a reasonable pre-filing investigation and isolated factual errors in RICO claim made in good faith.)

B. Did Counsel Conduct a Sufficient Pre-Filing Inquiry into the Law of Standing?

Rule 11 requires a sufficient pre-filing inquiry into the law to determine whether the complaint, as filed, was warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law. However, Rule 11 was not intended to "chill innovative theories and vigorous advocacy that bring about vital and positive changes in the law. . . . It does not mean the end of doctrinal development, novel legal arguments or cases of first impression." *Donaldson v. Clark*, 819 F.2d 1551, 1561 (11th Cir. 1987). But if litigants "attempt to pursue civil litigation with legal theories apparently foreclosed by statute and precedent, they must do so with candor toward the court and with a sense of whether their argument is appropriate and reasonable." *United States v. Milam*, 855 F.2d 739, 745 (11th Cir. 1988).

Plaintiff's counsel testified at the hearing that he spent approximately sixty hours researching and preparing plaintiff's complaint. (Tr. pp. 102). Plaintiff's counsel estimated that from fifteen to twenty-five percent of the sixty hours was spent on the standing issue. (Tr. p. 105).

Plaintiff's counsel admitted during his testimony at the sanctions hearing that he found no case in his pre-filing research which supported the position that a contributor to a charity or an employee thereof had standing to bring a derivative suit on behalf of the charity. (Tr. p. 100). He researched case law on standing including (*Flast v. Cohen*, 392 U.S. 102 (1968), which was cited in plaintiff's Memorandum in Support of Sufficiency of Complaint (Dkt. 11), and also found a dissenting opinion in the case of *Sierra Club v. Morton*, 405 U.S. 727, 741-752 (1972) (Douglas, J. dissenting) which supported the general proposition that standing should be liberalized and that it should not be an impediment to reaching the merits of the case. (Tr. pp. 102-103). Counsel's only prior exposure to the law relating to RICO was in conducting research for this case and a seminar he attended on the subject. (Tr. p. 104). Thus he was presumably aware that a civil action for damages under the federal RICO Act may be brought only by a person "injured in his business or property by reason of a violation [of] the Act." 18 U.S.C. § 1964(c).

Plaintiff's counsel took the position throughout the case that public policy and common sense supported the theory of standing advanced in the complaint. It could be discerned from counsel's arguments in his memoranda in support of the complaint and in opposition to the summary judgment motion that he was presenting plaintiff's

standing argument as a new theory, and counsel explicitly argued that Rule 23.1, Fed.R.Civ.P. dealing with shareholder derivative actions did not apply to this case.

It does not appear to the undersigned that counsel has ever attempted to mislead or deceive the court or opposing counsel during the course of this litigation concerning plaintiff's theory of standing.[9] Counsel has consistently characterized plaintiff's suit as a derivative suit brought on behalf of APC, using analogies in the law. He has raised public policy and equity arguments that a contributor should have standing to sue on behalf of a non-profit corporation for alleged wrongs of its directors on the theory that the directors would have no incentive to bring suit on behalf of the corporation. *Compare Milam, supra* at 745 (Rule 11 violated where counsel made no arguments based on public policy, analogy or equity); *DeSisto College, Inc. v. Line*, 888 F. 2d 755, 766 (11th Cir. 1989) (Rule 11 violated where counsel's position on law indicated either insufficient research which would have led to discovery of adverse binding precedent or bad faith in failing to disclose those authorities).

Accordingly, the undersigned concludes that although defendants' motion for summary judgment was granted on the grounds that plaintiff lacked standing, sanctions are not warranted on the basis of any insufficient pre-filing inquiry regarding basis in law to bring suit. *See O'Neal v. DeKalb County, Ga.*, 850 F.2d 653, 658

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[9] Memorandum in Support of Sufficiency of Complaint (Dkt. 11, pp. 4-5; Response to Defendant Directors' Motion for Summary Judgment (Dkt. 101, pp. 2-3).

(11th Cir. 1988) (action not frivolous merely because summary judgment granted). Further, it does not appear that plaintiff's counsel advanced a position regarding standing to sue which was intended to mislead or deceive the court.

C. Was Suit Filed for an Improper Purpose?

An attorney or party may be sanctioned under Rule 11 for filing a pleading for an improper purpose, such as to harass the opposing party. *See Milam, supra* at 742.

In the hearing on sanctions, plaintiff that he felt a responsibility to uncover apparent wrongdoing concerning actions which he felt were contrary to the charitable purposes of the hospital, and did not want to be personally associated with such activities. He stated that he filed the lawsuit under the belief that he should "confront wrong in the community," and that this belief was a motivating factor in his decision to finally file suit to correct the wrong. Dr. Lewis also stated that he came to the conclusion in February, 1986 that no one else would be able to correct the wrong that he perceived and he "came to the realization that he had to do something."

There is no suggestion in the record before the undersigned that plaintiff or his counsel filed this suit in bad faith or for the purposes of harassing defendants or forcing defendants to offer him a quick cash settlement out of the alleged profits the directors made on the sale of the hospital.[10] Nor does the preponderance of evidence

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[10] There is conflicting testimony as to whether Dr. Lewis told Dr. Wellborn that he was angry because he had not been

(Continued on following page)

establish that plaintiff filed this suit only to obtain discovery for use by the Florida Attorney General in a subsequent state court action brought to enforce the terms of APC's charter.[11]

Whether a signator of a pleading or a party acted with an improper purpose in filing suit is judged under an objective standard. *See Milam, supra* at 743; *Brown v. Federation of State Medical Bds.*, 830 F.2d 1429, 1436 (7th Cir. 1987). Harassment, within Rule 11, is not determined by the effect of the challenged conduct on the opposing party – whether, for example, the conduct did in fact bother, annoy or vex. The focus is on the improper purpose of the signer, objectively tested, rather than the consequences of the signer's act, subjectively viewed by the signer's opponent. *Zaldivar v. City of Los Angeles*, 780 F.2d 823, 831-32 (9th Cir. 1986).

After considering the record and the testimony at the hearing on sanctions, the undersigned cannot conclude

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(Continued from previous page)

included in the APC/AMH sale. (Tr. 181-182; 199). Dr. Lewis denies making any such statement and the undersigned finds his testimony more credible than that of Dr. Wellborn on this issue.

[11] On May 9, 1989, the Honorable J.C. Cheatwood, circuit judge, found that the defendant directors improperly used APC in violation of its charter and had purchased APC assets at less than fair market price. The court found, however, that no remedy other than dissolution of the corporation was authorized by state law. The case is on appeal. (Pltf's Ex. 2). It appears that the Florida legislature is considering an amendment to Florida Statutes Section 617.09 to permit the Department of Legal Affairs to recover profits improperly received in light of Judge Cheatwood's opinion. (Pltf's Ex. 3; Tr. 2 pp. 5).

that plaintiff or his counsel filed this action for an improper purpose. Therefore, sanctions are not warranted under the improper purpose element of Rule 11.

V. 28 U.S.C. § 1927 and Court's Inherent Power

Defendants also seek sanctions against plaintiff's counsel for excessive costs, fees, and expenses under 28 U.S.C. § 1927, pursuant to which:

> Any attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct.

28 U.S.C. § 1927 (as amended 1980).

The court also has the inherent power to assess attorneys' fees in certain cases of particularly egregious conduct on the part of attorneys practicing before it. *See Roadway Express, Inc. v. Piper,* 447 U.S. 752 (1980).

Sanctions under § 1927 or the court's inherent power are reserved for more egregious instances of bad faith conduct on the part of counsel. *See e.g. Pfister v. Delta Air Lines, Inc.*, 496 F. Supp. 932, 936-939 (N.D. Ga. 1980) (court noted that conduct of counsel in filing numerous unwarranted, bad faith, and scurrilous pleadings was "the most outrageous and unprofessional conduct on the part of an attorney that this Court has ever encountered").

The conduct of plaintiff's counsel in this case, apart from the Rule 11 pre-filing inquiry issue, was not unreasonable or vexatious so as to warrant sanctions under § 1927 or pursuant to *Roadway Express.*

VI. Type and Amount of Sanctions

Having determined that Rule 11 has been violated by plaintiff's counsel for failure to conduct an adequate pre-filing investigation into certain aspects of the complaint, a sanction is mandatory.

In the case at bar, defendant seeks the award of attorney's fees and costs, broken down as follows:

1. $157,630.02 in attorney's fees incurred by John Bush;

2. $8,223.50 in paralegal fees assisting John Bush;

3. $49,381.28 in costs incurred by Mr. Bush;

4. $80,896.72 in attorney's fees incurred by Edward Booth hired by defendants as criminal law counsel;

5. $18,877.86 in costs incurred by Mr. Booth;

6. $125,508.09 in attorney's fees claimed by defendant, James D. O'Donnell, Esq.;

7. $27,858.50 in costs incurred by Mr. O'Donnell;

8. $5,000.00 representing the amount of the deductible paid by Mr. O'Donnell to his malpractice insurance carrier following the company's review of the papers filed in this case.[12]

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[12] The legal fees and costs for Mr. Bush and his paralegal include time spent at the appellate level as well as the proceedings in the district court. (Def's Ex. 11, Tr. p. 2).

Plaintiff objects to the amount of fees claimed by defendants and to specific items included as costs as well as the propriety of defendant O'Donnell receiving fees and costs associated with this action and the necessity of the assistance of Edward Booth.

In determining the amount of sanctions which a court may impose within its discretion for violation of Rule 11, courts have set forth a number of factors to aid such a determination. Among the factors considered are: the good faith or bad faith of the offender, the degree of willfulness in the offense, the knowledge and experience of the offender, the ability of the offender to pay any award, the nature and extent of the prejudice on the offended party, and the relative magnitude of the sanction in light of the goals of the sanction. *See e.g. Eastway Const. Corp. v. City of New York*, 821 F.2d 121, 123 (2d Cir.), *cert. denied*, 484 U.S. 918 (1987); *Matter of Yagman*, 796 F.2d 1165, 1185 (9th Cir. 1986); *see generally ABA Standards, supra*, at 125-126.

Commentators have stated that in assessing a sanction under Rule 11, the court should impose the least severe sanction adequate to serve the purposes underlying Rule 11 which it seeks to implement. *ABA Standards, supra*, at 124.

In this particular case, the undersigned has determined that plaintiff's counsel has not acted in bad faith or manufactured evidence, but merely relied unreasonably solely upon the information provided by his client as to some of the RICO allegations of the complaint. The undersigned has no knowledge of prior sanctionable conduct on the part of plaintiff's counsel and, throughout the

case, plaintiff's counsel's conduct before the undersigned has been appropriate.[13] No information was introduced at the hearing as to plaintiff's counsel's ability to pay a monetary sanction.

On the other hand, a mere reprimand would be too mild, given the magnitude of the allegations brought against defendants, the size of the fees and costs incurred in defending the case and the extensive publicity which resulted. (Def's Ex. 7).

In light of the foregoing analysis, the undersigned concludes that under the circumstances the imposition of sanctions against plaintiff's counsel in the total amount of the attorney's fees billed by defendants' counsel to his clients would be too harsh. Nor does the undersigned find that the conduct on the part of plaintiff's counsel, given the totality of the circumstances, justify requiring counsel to pay even a significant part of such total fees, given that the mere finding of a Rule 11 violation by counsel is a penalty in and of itself.

Instead, I find that the proper remedy for the sanctionable conduct by plaintiff's counsel would be to require counsel to compensate defendants for the fees associated with the preparation of defendants' motion for sanctions filed in the district court and for the services rendered by defendants' counsel, Mr. Bush, in arguing the motion for sanctions at the hearing before the undersigned held on April 27, 1990 and April 30, 1990.

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[13] A number of discovery motions were filed in the case and ruled on by the undersigned magistrate. Two hearings were also held.

After reviewing counsel's affidavit in support of his fees request and the billing records admitted as an exhibit at the hearing, the undersigned concludes that the amount of $4,420.00[14] is an appropriate amount of monetary sanctions to require plaintiff's counsel to pay to defendants, *pro rata*.

Because of the undersigned's finding that the plaintiff did not violate Rule 11, the undersigned concludes that plaintiff's counsel alone should pay this amount.

It is, therefore, respectfully recommended,

(1) that Defendants' (Except Smith) Motion for Sanctions (Dkt. 122) be GRANTED in part, in accordance with the foregoing.

Respectfully submitted,

/s/ Elizabeth A. Jenkins
ELIZABETH A. JENKINS
United States Magistrate

Dated: May 3rd, 1990.

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[14] Approximately seven hours were spent by counsel in presenting the motion for sanctions before the undersigned at the hearing held on April 27, 1990 and April 30, 1990. Mr. Bush presently bills his clients at a rate of $200.00 per hour according to his affidavit. Therefore, it appears that $1,400.00 would adequately compensate defendants for payment of fees to Mr. Bush for his services associated with the sanctions hearing. The remainder of the fees awarded, $3,020.00, the undersigned finds to be the reasonable amount of fees, based on submissions provided by Mr. Bush, for services rendered by Mr. Bush to defendants in connection with preparing the motion for sanctions.

NOTICE TO PARTIES

Failure to file written objections to the proposed findings and recommendations contained in this report within ten (10) days of its receipt shall bar an aggrieved party from attacking the factual findings on appeal. 28 U.S.C. § 636(b)(1).